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Supreme Court of the United States

OCTOBER TERM, 1937

No. 1

THE ATLANTIC REFINING COMPANY,
Appellant,

vs.

COMMONWEALTH OF VIRGINIA, *Appellee.*

APPEAL FROM THE SUPREME COURT OF APPEALS OF THE STATE OF VIRGINIA

Supplemental Reply Brief for Appellant.

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Supplemental Reply Brief for Appellant.

Explanatory Statement

This case, involving the validity of the fee imposed by the State of Virginia upon foreign corporations for the privilege of entering to do a local business, was No. 40 on the Docket of this Court at its October Term, 1936.

It was argued orally and submitted on October 21st and October 22, 1936. No decision having been handed down, an order was entered on June 1, 1937, restoring this case to the docket, and directing a reargument.

A careful check of the authorities has disclosed no case decided since the submission of this cause in October 1936 which, in the opinion of Appellant, bears directly upon the questions presented by this appeal.[1] Moreover, a re-examination of the entire record in this case, as well as the applicable authorities, has satisfied Appellant that its position has been fully stated and argued in its Jurisdictional Statement, in its Brief in Reply to Appellee's Statement Opposing Jurisdiction, and in its main Brief, previously filed herein. Accordingly, Appellant believes that no proper or useful purpose could be served by filing an additional brief containing, as would necessarily be the case, a reiteration of matters already deemed to have been fully covered.

However, Appellant is advised by counsel for the State of Virginia that such counsel intend to argue that the recent case of *Great Atlantic & Pacific Tea Company* v. *Grosjean,* 81 L. Ed. (Adv. Sh.) 735 (decided May 17, 1937) lends support to the validity of the Virginia statute here in question. In view of such announced intention, Appellant considers it proper to submit this Supplemental Reply Brief in what might be deemed anticipatory rebuttal of Appellee's new argument. The discussion which follows will be limited to an analysis of the *Grosjean Case,* and to the pointing out of the features which clearly distinguish it from the instant case.

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[1]The one exception is the case of *Southern Natural Gas Corp.* v. *Alabama,* 81 L. Ed. (Adv. Sh.) 695, decided April 26, 1937, which is mentioned *infra,* in connection with Appellee's contention considered in this Supplemental Brief.

The Case of *Great Atlantic & Pacific Tea Co.* v. *Grosjean*

The *Grosjean Case* involved the validity of the Louisiana Chain Store Tax,[2] which was described as "an occupation or license tax" levied upon the business of conducting chain stores within the State of Louisiana. Section 2 of the Louisiana law stated that the tax was imposed "because of the advantages accruing from the operation of multiple stores wherever situated and because of the basic difference inherent in the character of operations." Section 3 thereof provided that the tax "shall be based on the number of stores or mercantile establishments included under the same general management * * * whether operated in this State or not, and shall be fixed and graded as follows, to-wit: (1) Upon stores or mercantile establishments operated in this State and belonging to a chain or group having a total of not more than ten stores, the annual license shall be Ten Dollars ($10.) for each such store operated in this State." There were fifteen additional paragraphs progressively increasing the rate per store in Louisiana of larger chains.

The Great Atlantic & Pacific Tea Company, having 15,082 stores in the United States and elsewhere, came within the rate prescribed for "chains of more than five hundred," and accordingly was required to pay a tax of $550. on each of its 106 stores situated in Louisiana. As this Court pointed out, "the measure of the exaction" was the number of units of the chain within the State, while the rate of tax for each such unit was fixed by reference to the size of the entire chain.

In disposing of the contention that the Louisiana Act contravened the equal protection clause of the Fourteenth

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[2]Act 51, La. Leg. 1934.

Amendment, the Court pointed out that the reasons announced by the Legislature in Section 2 of the Act for the imposition of the tax were fully sustained by the established facts:

> "The District Court found that the testimony offered by the State was similar to that in *State Tax Comrs.* v. *Jackson,* 283 U. S. 527, 75 L. ed. 1248, 51 S. Ct. 540, 73 A. L. R. 1464, 75 A. L. R. 1536, *supra;* established the difference in type of operation between the operator of one store and the operator of many, and the variance in advantage and mode of operation with the number of units in the chain. In addition, the court found that all the stores of a retail chain contribute to the central purchasing power of the chain irrespective of state lines and location of stores, and increase the per unit multiple advantage enjoyed by the operator of the system; that the greater the number of units the greater the purchasing power of the chain, the greater the rebates and allowances, the greater the advantages in advertising, the greater the capital employed, the greater the social and economic consequences, and the lower the cost of distribution and overhead. 'In fine, the record in this case shows the contribution to the advantages made by each unit in the chain, and the per unit advantage made possible by the whole system, and in that respect only does it differ materially from the proof which was before the court in the *Jackson Case.*' These findings are assigned as error, but they have substantial support in the record and we therefore accept them.
>
> "If the competitive advantages of a chain increase with the number of its component links, it is hard to see how these advantages cease at the state boundary. * * * " (p. 737)

In the light of the foregoing findings it was held:

"* * * Thus it appears that the classification is not based upon the location of the stores within or without the state but upon the type of business conducted, the scale of that business, its accompanying competitive advantages and economic results.

* * * * * *

"The statute bears equally upon all who fall into the same class, and this satisfies the guaranty of equal protection" (p. 739).

The second major contention was that the Act deprived the companies involved of property without due process "because the tax is imposed, at least in part, upon things which are beyond the jurisdiction of Louisiana." This contention was disposed of on two grounds. It was first pointed out that the subject of the tax—the conduct of a chain store business in Louisiana—was a legitimate subject of a license or occupational tax, and that the measure of the exaction was "the number of units of the chain *within the State*," a measure said to be sanctioned by the decisions of this Court. Only the rate of the tax for each such unit was fixed by reference to the size of the entire chain, and this was held insufficient to constitute a taxing of property beyond the borders of Louisiana.

In the second place, and as the fundamental basis of the decision, it was held that the State's *police power* fully justified the reference to the size of the entire chain in fixing the rate per unit within the State. The Court's exposition of this view conclusively demonstrates the inapplicability of the Grosjean decision to the instant case, and therefore merits full quotation:

"Our decision need not, however, rest on conceptions of subject, measure and rate of tax. Much

broader considerations touching the state's internal policy of police sustain the exaction. The tax is laid solely upon intrastate commerce. In the exercise of its police power the state may forbid, as inimical to the public welfare, the prosecution of a particular type of business, or regulate a business in such manner as to abate evils deemed to arise from its pursuit.

* * * * * *

"Taxation may be made the implement of the exercise of the state's police power; and proper and reasonable discrimination between classes to promote fair competitive conditions and to equalize economic advantages is therefore lawful.

"If, in the interest of the people of the state, the legislature deemed it necessary either to mitigate evils of competition as between single stores and chains or to neutralize disadvantages of small chains in their competition with larger ones, or to discourage merchandising within the state by chains grown so large as to become a menace to the general welfare, it was at liberty to regulate the matter directly or to resort to the type of taxation evidenced by the Act of 1934 as a means of regulation. * * *" (pp. 740-41.)

The *Grosjean Case* Lends No Support to the Validity of the Tax Here in Question

Counsel for the State of Virginia have indicated that they will argue that the *Grosjean Case* supports the validity of the Virginia tax imposed on foreign corporations for the privilege of entering to do a local business. This argument seems to be as follows: The rate of the Louisiana Chain Store Tax is determined by the "size of the entire chain", including stores located in foreign states; this was held not to constitute a taxing of property beyond the jurisdiction of Louisiana; therefore, Section 207 of the Virginia Tax Code, imposing a tax upon

foreign corporations, both the rate and measure of which are determined by total authorized capital representing the corporation's business and property wherever located, does not effect a taxing of property beyond the jurisdiction of Virginia.

Although such argument is believed to be manifestly unsound on its face, we shall now specifically designate and discuss the distinguishing features of the two exactions, and show that the validity of the Virginia tax is not in any way supported by this Court's decision in the *Grosjean Case.*

First. If conceptions of subject, measure and the rate of a tax are considered, as they were in the case under discussion, an important distinction is immediately found to exist. The Louisiana tax, as this Court pointed out, was measured by "the number of units of the chain within the state—a measure sanctioned by our decisions." Only the rate of the tax for each such unit was fixed by reference to the entire chain. The Virginia tax, however, is measured solely and entirely by the foreign corporation's total authorized capital, which "represents all of its business of every class and all of its property wherever located."[3] Likewise, its rate is determined solely by total authorized capital stock.

In other words, the Louisiana tax is related directly to and is measured by the stores located within the State, while *the Virginia exaction in question has no relation whatever to any local subject or activity.* This characteristic of the Virginia tax, which in itself distinguishes it from the chain store tax, has been held repeatedly to establish the invalidity of like statutes.[4]

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[3]*International Paper Co.* v. *Mass.*, 246 U. S. 135, 142.

[4]See cases cited in Appellant's Brief, heretofore filed.

Second. A conclusive distinction lies in the nature and purpose of the two exactions. The Louisiana tax was sustained as a valid exercise of the State's police power, while the Virginia tax here in question has no relation whatever to police power, being imposed upon all foreign corporations as a charge for the privilege of entering the State to engage in intrastate business therein. That this distinction is controlling becomes apparent from an examination of the Court's reasoning in the *Grosjean Case.* Mr. Justice Roberts, after pointing out that the "measure" of the tax was confined to units within the State, proceeded on to the "much broader considerations touching the State's internal policy of police," which were expressly found to "sustain the exaction." There were findings that the business practices (such as rebates and allowances) and the superior economic advantages (such as national advertising and large scale purchasing) of chain stores constituted "local evils", and that such "local evils" resulted from and varied directly with the size of the chain. The Court further found that the public policy of Louisiana to correct these evils within the State would be frustrated and "set at naught" if the size and magnitude of the chain everywhere could not be considered by the Legislature. In this connection, the Court said:

> "* * * The appellants, by incorporating in some other state, or by spreading their business and activities over other states, cannot set at naught the public policy of Louisiana. The claim is, essentially, that even if local evils flow from the appellant's methods the state cannot control those evils because its power is limited to conditions created by the members of the chain found within the state. The conclusion is that the state must treat these stores as

> if they were something different from what they really are, since to do otherwise would be to reach beyond the borders of Louisiana for the measure of the tax. The argument answers itself. The policy Louisiana is free to adopt with respect to the business activities of her own citizens she may apply to the citizens of other states who conduct the same business within her borders, and this irrespective of whether the evils requiring regulation arise solely from operations in Louisiana or are in part the result of extra-state transactions. It is not a denial of due process to adjust such license taxes as are here involved to meet the local evil resulting from business practices and superior economic power even though those advantages and that power are largely due to the fact that the taxpayer does business not only in Louisiana but in other states" (p. 741).

It is thus evident that the Louisiana Chain Store Tax was sustained as a police measure, designed to mitigate specified evils and to neutralize disadvantages of the small local merchants. Manifestly, therefore, the sustaining of such a measure affords no precedent for upholding the Virginia tax imposed upon the authorized capital stock of all foreign corporations for the privilege or right of doing a local business within the State. No "local evil" or other basis for the exercise of police power exists in this case; and in fact the State of Virginia has never attempted to sustain or justify this exaction as an exercise of its police power. The sole basis here relied upon is the long recognized power of a State to exclude foreign corporations from doing a local business, and to impose charges and conditions as the price of granting the privilege to engage in such a business.

Third. It is patent that this Court did not consider the Louisiana Chain Store Tax to be analogous to privi-

lege taxes imposed on foreign corporations for the privilege of doing a local business. As the briefs heretofore filed amply demonstrate, there are numerous decisions by the Supreme Court involving the validity of such taxes on foreign corporations, and which expressly discuss the extra-territorial effect of measuring a tax by authorized capital. *Yet none of such decisions is cited or mentioned in the Grosjean opinion.* Stemming back to *Western Union Telegraph Co.* v. *Kansas,* 216 U. S. 1, and culminating in *Cudahy Packing Co.* v. *Hinkle,* 278 U. S. 460, there is a long line of decisions by this Court holding invalid privilege taxes imposed on foreign corporations where measured by authorized capital stock. It cannot be supposed that the soundness of all of these cases was questioned by the Chain Store Tax case, without even so much as a reference to one of them. Yet this is the necessary consequence of Appellee's argument that the *Grosjean Case* is authority for the validity of a privilege tax on foreign corporations measured by total authorized capital, representing the business of such corporations, both interstate and intrastate, and their property wherever located.

The truth is that the decisions on the power of a State to impose privilege taxes on foreign corporations constitute a separate and very important body of our constitutional jurisprudence, involving in essence a State power different and distinct from the police power. The decision in the *Grosjean Case* was not intended to, and did not in fact, invade the domain of privilege taxes on foreign corporations, and there upset long established doctrines of constitutional law.

Fourth. The case of *Southern Natural Gas Corp.* v. *Alabama,* 81 L. Ed. (Adv. Sh.) 695, decided on April

26, 1937, only three weeks before the Grosjean decision, is further evidence that the Louisiana case involved different principles from those applicable to privilege taxes on foreign corporations, and is no authority for the validity of such a privilege tax measured by total authorized capital. In the *Southern Natural Gas Corporation Case* the privilege tax imposed by Alabama "upon foreign corporations as a prerogative to the right of exercise of corporate functions in the State" was sustained. The measure of such tax, however, was "the actual amount of capital employed" in Alabama, and this Court by its unanimous opinion was careful to point out:

> "As Alabama was competent to lay a franchise tax upon appellant for the privilege of doing an intrastate business, it was competent to measure the tax by the capital employed within the State provided the tax was not so laid as to discriminate against interstate commerce or otherwise lay a direct burden upon it.
>
> * * * * * *
>
> *"There is here no attempt to tax property that is beyond the boundaries of the State. The tax was laid only upon property employed within the State and enforcement is left to the ordinary means of collecting taxes.* * * *" (p. 700.) (Italics supplied.)

The foregoing language clearly recognizes that the property of a foreign corporation in other jurisdictions may not validly be reached by a tax or fee on the privilege of doing a local business. It also emphasizes that a valid charge for the privilege of entering or remaining within a State to do a local business must be related to the privilege conferred, such as the property used or to be used, or the business carried on or to be carried on,

within the State.[5] The *Grosjean Case,* decided three weeks later, contains no reference to the *Southern Natural Gas Corporation Case,* which in itself is a significant indication that no principles applicable to privilege taxes on foreign corporations were affected by the sustaining of the Louisiana Chain Store Tax. The views expressed in the *Southern Natural Gas Corporation Case* are entirely consistent with the decisions relied upon by The Atlantic Refining Company on this appeal.

Conclusion

In view of the foregoing, it is respectfully submitted that there is no merit whatever to Appellee's claim that the tax here in question is supported by the decision in *Great Atlantic & Pacific Tea Co.* v. *Grosjean.* Accordingly, the determination of this appeal involves a consideration and application of the numerous decisions dealing with privilege taxes on foreign corporations, which decisions have been fully discussed in Appellant's main Brief.

That the Virginia entrance fee, imposed upon foreign corporations for the privilege of entering to do a local business, unlawfully burdens interstate commerce and reaches property in other jurisdictions, is believed to be plainly settled by *Cudahy Packing Co.* v. *Hinkle, supra.*[6]

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[5]See "Appendix A" to Appellants main Brief for examples of the manner in which most of the states have avoided the arbitrary measure of authorized capital stock.

[6]As Mr. Justice Brandeis correctly pointed out in his dissent in that case, the Washington filing fee held invalid there was indistinguishable from the Virginia entrance fee here involved. 278 U. S. 460 at p. 468. Even the court below admitted that the Washington filing fee was "in principle quite like the Virginia entrance fee." *Atlantic Refining Co.* v. *Commonwealth,* 165 Va. 492, 500.

That the Virginia act also infringes the equal protection clause, is believed to be settled by *Air-Way Electric Appliance Corp.* v. *Day*, 266 U. S. 71.

The *Cudahy Packing Co.* and *Air-Way Electric Appliance Corp. Cases*[7] have finally restored a large measure of certainty to this important field of constitutional law, and have thereby eliminated the confusion and doubt occasioned by the now "disapproved" decision in *Baltic Mining Co.* v. *Mass.*, 231 U. S. 68, and its off-spring, *General Railway Signal Co.* v. *Virginia*, 246 U. S. 500. State courts in numerous jurisdictions, endeavoring to adjust their rulings to the mandate of this Court, have recently followed the *Alpha Portland Cement Co.*, the *Air-Way Electric Appliance Corp.* and the *Cudahy Packing Co. Cases*, and accordingly have held invalid charges imposed either at the time of entrance or thereafter, whenever based upon the total authorized capital of foreign corporations.[8]

The decision by the Virginia court below, which is the subject of this appeal, is believed to be the only case decided since 1918, and not subsequently overruled or reversed, which sustains a charge upon a foreign corporation measured solely by total authorized capital stock, where such corporation has property situated in other jurisdictions, and is also engaged in interstate commerce.

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[7]Together with *Alpha Portland Cement Corp.* v. *Mass.*, 268 U. S. 203.

[8]*Perkins Mfg. Co.* v. *Jordon*, 200 Calif. 667, 254 Pac. 551; *Badger* v. *Crockett*, 70 Utah 265, 259 Pac. 921; *Minneapolis Steel & Machinery Co.* v. *Crockett*, 263 Pac. 926, 71 Utah 211; *Chicago, etc., Ry.* v. *Harman*, 295 Pac. 762, 89 Mont. 1; *State* v. *Liggett & Myers Tobacco Co.*, 171 S. C. 511, 172 S. E. 857; *Montgomery Ward & Co.* v. *Becker*, 69 S. W. (2d) 674, 334 Mo. 789; *Great Northern Ry. Co.* v. *State*, 147 Wash. 630, 267 Pac. 512; and *State ex rel. Borden Co.* v. *Dammann*, 224 N. W. 139, 198 Wisc. 265.

If the opinion below is now affirmed by this Honorable Court, it is respectfully submitted that the law on this subject will again revert to its former state of confusion and uncertainty, and the courts of more than a dozen States will have to revise or reverse their positions with respect to authorized capital stock as a legitimate measure for privilege taxes on foreign corporations.

Of course Appellant recognizes that the foregoing considerations, however important, do not warrant the perpetuation of an incorrectly decided doctrine. It is submitted, however, that the doctrine established by this Court in *Western Union Telegraph Co.* v. *Kansas, supra,* and more recently reaffirmed in *Cudahy Packing Co.* v. *Hinckle, supra,* is eminently sound in principle and should indeed be perpetuated. This doctrine, briefly stated, is that the total authorized capital stock of a corporation "represents all of its business of every class and all of its property wherever located,"[9] and that therefore a tax or fee imposed upon a foreign corporation for the privilege of entering or remaining to do a local business measured by such capital stock "is essentially and for every practical purpose a tax" on all of its business, both interstate and intrastate, and on all of its property wherever located, in violation of the commerce and due process clauses of the Federal Constitution. Moreover, the further doctrine, equally sound, was established by the *Air-Way Electric Appliance Corporation Case,* to the effect that *authorized* capital is an arbitrary and unreasonable measure for a privilege tax upon foreign corporations, bearing no relation whatever to the privilege conferred and therefore violating the equal protection clause of the Fourteenth Amendment.

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[9] *International Paper Co.* v. *Mass., supra,* at p. 142.

Accordingly, Appellant respectfully submits that the decision by the court below is contrary to the controlling decisions of this Court, is contrary to all state court decisions on this subject decided since 1918, and is plainly violative of sound and settled principles of constitutional law; and that therefore the judgment below should be reversed.

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